STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Verizon North Inc. (f/k/a GTE North Incorporated) and Verizon South Inc. (f/k/a GTE South Incorporated)	:	
	:	**Docket No. 00-0812**
Petition seeking approval of Cost Studies for Unbundled Network Elements, Avoided Costs, and Intrastate Switched Access Services	:	

REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Table of Contents

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The Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, and pursuant to Section 200.800 of the Illinois Commerce Commission's Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits this reply brief in the above-captioned proceeding.

I. INTRODUCTION

For purposes of Phase I of this proceeding, Staff filed its Initial Brief of the Illinois on October 21, 2002 ("Staff IB" or "Staff's Initial Brief"). The following initial briefs were filed on October 21, 2002 for Phase I: the Initial Brief of Verizon North Inc. and Verizon South Inc., ("Verizon IB"), the Initial Brief of the Illinois Rural Competitive Alliance ("IRCA IB"), and the Initial Brief of AT&T ("AT&T IB"). As stated by the parties to this docket, Verizon petitions this Commission to approve its cost analyses for unbundled network elements ("UNEs"), avoided costs and intrastate-switched access services. Verizon has provided the Commission with its Integrated Cost Model version 4.4 ("ICM"

and the "model") to support the company's cost development analysis. *See* Verizon Petition.

In the current phase of this proceeding, Phase I, the Commission will make the following findings: (1) whether ICM is a proper cost model for the determination of long run incremental costs ("LRSICs") and total element long run incremental costs ("TELRICs"); and (2) whether the switched access charges proposed by Verizon in Phase I are based upon acceptable, and otherwise TELRIC-compliant costs. Although few disputes remain, the initial briefs confirm that many parties to this proceeding support all or a significant portion of Staff's recommendations and virtually all parties support some portions of Staff's Proposed Interim Rates. Staff has performed fair, acute and reasonable analyses of the model. Staff identified defects and proposed broad changes necessary to bring the model into compliance with TELRIC principles. For the most part, Verizon elected not to make these changes. Therefore, Staff has recommended the Commission Order reject Verizon's model until such time as Verizon is able to correct the deficiencies identified by Staff and Staff and other interested parties have had adequate opportunity to review these changes to ensure that they are implemented consistent with TELRIC principles. Moreover, Staff's position remains consistent with the framework of the General Assembly's policy goals of promoting competition in the telecommunications industry.

In this reply brief, Staff responds to Verizon's criticisms, however, in the interest of brevity, Staff will not reiterate points previously made in its Initial Brief. Rather, Staff will comment on several positions raised in Initial Briefs filed by the parties to this proceeding. To the extent that Staff does not address an argument in this Reply Brief

that was raised in it's Initial Brief, this should not be deemed a waiver, but rather the Staff's arguments should be deemed fully reiterated herein. Similarly, the omission of a response to arguments put forth in the initial briefs of the parties to this proceeding should a not be considered a waiver by the Staff. Instead, this silence indicates Staff's belief that no further comment is necessary.

As a final point, minor modifications to Staff's Proposed Interim Switched Access Rates ("Interim Rates") have been estimated by the parties. Although due process requires the Commission to consider these estimates, Staff remains confident that its approach will prevail. Indeed, Staff's Interim Rates are reasonable, fair, and proper, as well as consistent with the intent of the General Assembly, and thus should be adopted by this Commission.

II. LEGAL STANDARDS

A. Standard of Proof

Section 10 –15 of the Illinois Administrative Procedure Act provides that "unless otherwise provided by law or stated in the agency's rules, the standard of proof in any contested case hearing conducted under this Act by an agency shall be the preponderance of the evidence." 5 ILCS 100/10-15. As neither the provisions of the Public Utilities Act governing, *see, generally* 220 ILCS 5/13-401 *et seq*., nor the Commission's Practice Rules, *see generally*, 83 Ill. Admin. Code 200.200 *et seq*., specify any other standard, the standard of proof in this case is the preponderance of the evidence.

B. Burden of Proof

The term "burden of proof" includes the burden of going forward with the evidence, and the burden of persuading the trier of fact. People v. Ziltz, 98 Ill. 2d. 38, 43

(1983). The burden of persuading the trier of fact does not shift throughout the proceeding, but remains with the party seeking relief. Ambrose v. Thorton Twp. School Trustees, 274 Ill. App. 3d 676, 690 (1st Dist. 1995), *app. den.*, 164 Ill. 2d 557 (1995); Chicago Board of Trade v. Dow Jones & Co., 108 Ill. App. 3d 681, 686 (1st Dist. 1982).

It is a well-established principle that a petitioner in an administrative proceeding has the burden of proof, and relief will be denied if he fails to sustain that burden. Hamwi v. Zollar, 299 Ill. App. 3d 1088, 1092-93; 702 N.E.2d 593; 234 Ill. Dec. 253 (1st Dist. 1998). Indeed, the Illinois Supreme Court has gone so far as to state "courts have **uniformly** imposed on administrative agencies the customary common-law rule that the moving party has the burden of proof." Scott v. Dept. of Commerce and Community Affairs, 84 Ill. 2d 42, 53; 416 N.E.2d 1082 (1981) (emphasis added).

As noted above, the general and well-established rule that a party seeking judicial relief has the burden of demonstrating his or her right to it, applies with respect to Commission cases. The evidence in this proceeding, taken as a whole demonstrates that Verizon has failed to meet this burden with respect to the areas of Staff's criticism. Accordingly, Staff's recommendations should be adopted.

III. STAFF'S REPLY TO VERIZON'S ARGUMENTS

A. ICM Results in Costs That Are Over-stated.

Staff acknowledges that ICM is flexible, easy to use, and efficient and that nearly all of the assumptions that drive decision rules within the model are user changeable. Staff Ex. 5.1 at 8. Although the above acknowledgements can be viewed as the model's strengths, Staff remains concerned with ease of flexibility. For example, the flexibility allows the possibility to modify inputs, which causes ICM to be susceptible to misuse.

Staff's standards for determining the flexibility and openness of ICM are indeed reasonable. In its brief, Verizon states "[w]hile he [Staff Witness Zolnierek] correctly identifies the three basic ways that a user can alter the ICM, he implies that the third method – modification of ICM's code – is not satisfactory and that any change ordered by the Commission must be accomplished by changing model inputs. Mr. [sic] Zolnierek has essentially proposed an impossible standard." Verizon Brief at 14, footnotes omitted. Staff disagrees.

Verizon has mischaracterized Staff's position with respect to the modification of ICM's code. As Staff has made clear in both testimony and in its initial brief, if Verizon is able to correct ICM's modeling deficiencies, Dr. Zolneirek has testified that he will reanalyze the company's switched access cost estimates and alter his recommendations accordingly. Staff Ex. 2.0 at 3. Dr. Zolnierek explicitly testified, "…the ultimate flexibility of the model depends on whether Verizon can make Commission-ordered changes in assumptions by merely manipulating run time options screens or data tables used as inputs into the ICM, or whether such changes require fundamental reprogramming of the model." Staff Ex. 2.1 at 13. Staff's position is clear and unambiguous. If Verizon can overcome any inflexibility in the model and remedy the deficiencies Staff has identified, then Staff will reevaluate the model methodology and revise its recommendations accordingly. There is no issue here of setting an "impossible standard", as Verizon asserts.

Verizon's response to Dr. Zolnierek highlights why the Commission must clearly identify what it is and is not approving in this phase of the proceeding. Verizon is requesting the Commission approve its ICM model. See Verizon IB at 7 ("…at a

minimum, the Commission should approve ICM in Phase I of this proceeding.") Verizon requests that the Commission approve the ICM model notwithstanding significant recoding that is necessary.

For example, in the event that the Commission determines that ICM should be designed to accept Vendor cost information *directly*, rather than accepting the information filtered through SCIS and COSTMOD, the Commission is effectively ordering a fundamental change in the model. In fact, an alteration in this manner and to this extent would essentially have the effect of preventing revisions to the model for purposes of directing the input of its pricing estimates. "There is no alternative to the approach that Verizon has taken with ICM which is to obtain pricing for a set of model office clusters and use this pricing to develop the SCIS and CostMod discount inputs." Verizon IB at 69. Contrary to Verizon's assertions, this is not a problem related to the model's inputs. Id. Verizon IB at 6-7. Rather it is a problem with the ICM itself. Effectively this alteration creates a model different from the ICM. Accordingly, Verizon cannot colorable assert that the Commission should approve the model if the Commission finds that recoding is required.

Verizon's arguments imply that, as long as the ICM can be modified to accommodate regulated changes, ICM is flexible and should be accepted. While this is perhaps true, it is also of little relevance to this proceeding. Presumably, with enough coding and input changes, Verizon's ICM model could be made to estimate the cost of tea in China. That, however, is not what the Commission is considering here. Verizon is requesting that the Commission approve the collective assumptions and associated algorithms that Verizon calls the ICM model. Staff has demonstrated that a number of

these assumptions and algorithms are deficient and result in improper cost estimation. Thus, the Commission should be clear that Staff rejects the ICM model but will reevaluate a model (by whatever name) that corrects the deficiencies identified by Staff.

In its Initial Brief Verizon claims that the costs estimates it has submitted in this proceeding are "…a lower bound on Verizon's long-run, forward-looking economic costs of provisioning telecommunications services in Illinois"; that the evidence in this proceeding "…demonstrates that there is downward bias in the results produced by ICM", that Verizon's forward looking costs are generally "understated"; and that ICM's switching costs are "very conservative." Verizon IB at 6, 15, 17. Verizon's assertions are incorrect. There are numerous assumptions made by Verizon that inflate its costs above the forward-looking costs prescribed by the Commission's Part 791 rules. *See* Staff IB at 24, *et seq*. Therefore, Verizon's assertions that its cost estimates are a lower bound and, consequently, that its cost estimates could not possibly be *above* actual forward looking costs, are simply false.

B. The ICM Modeled Network Is Inconsistent With Commission Cost Of Service Rules And FCC TELRIC Requirements

Verizon argues that, in Paragraph 685 of the FCC's *First Report and Order*, the FCC contemplates a reconstructed local network that implies economies of scope and scale that no incumbent will ever realize in the real world. It further claims that FCC's *Universal Service Order* also requires that the modeled loop network not impede the provision of advanced services, even if the existing network does not meet this requirement. Verizon claims that a cost model that reflects less efficient technology would not be consistent with either the FCC's or the Commission's requirements for forward-looking cost studies. The Commission's rules also require that costs be

modeled as if the service were being offered for the first time. ICM also includes the 18kf copper Revised Resistance Design standard that requires all copper loops greater than 18kf to be loaded.

It is difficult for Staff to concur with some of the model's assumptions. For instance, as Verizon indicates, ICM's switching costs are based on the following assumptions:

> 1. host/remote relationships and technology mix found in Verizon's Illinois network
> 2. switch prices obtainable today and the foreseeable future
> 3. input prices for material and labor are those that an efficient buyer would pay
> 4. material costs are obtained from actual contracts with vendors
> 5. labor costs are based on the actual cost of labor activities in Illinois.
> Verizon Reply Brief at 26.

Verizon additionally maintains, "ICM produces accurate estimates of Verizon's forward-looking switching costs in Illinois." Verizon IB at 22. To support its contention, Verizon states the following: (1) costs produced by ICM are based on Verizon's existing or embedded host/remote relationships and technology mix; and (2) costs produced by ICM are based on the switch prices that the company is able to obtain today. Verizon IB at 22. Staff cannot support these arguments.

The two factors Verizon identifies as supporting the accuracy of its forward-looking switching cost estimates in fact support precisely the opposite conclusion. Section 791.20(c) of the Commission's Cost of Service Rules very clearly states that "forward looking costs …are based on the least cost technology currently available whose cost can be reasonably estimated based on available data." 83 Ill. Admin. Code 791.20(c). While Verizon bases its estimates on current prices, it also bases the estimates on existing or embedded switching technology mixes, rather than the least

cost mix of these switching technologies, given current prices. An estimate based on embedded or existing technology mixes necessarily inflates costs, in comparison to an estimate based on mixes of such technologies that are least cost based on current prices. Therefore, the two factors Verizon cites as support for the accuracy of ICM in fact support exactly the opposite conclusion --- ICM produces estimates of Verizon's forward-looking switching costs in Illinois that are not accurate, but are in fact inflated.

C. Comparisons Of ICM's Results With The Results Of Earlier Cost Study Filings, Rates From Other Verizon Jurisdictions And Existing Rates is Improper

1. Comparisons To Verizon's Retail Monthly Access Charge Are Improper

The Commission should not accept the true-up calculation that Verizon witness Mr. Tucek advances to explain the differences between the current rates for services, and the costs modeled by ICM. Mr. Tucek takes three adjustments to reconcile these differences. First, he removes shared costs from ICM. Second, he removes the exchanges sold to Citizens Communications in December of 2000. Third, he excludes loops served by DLC's from the ICM network. With these adjustments, he runs the model under the 18kft option. The resulting TELRIC cost is shown to be similar to existing rates. Mr. Tucek argues that this exercise shows that ICM is not gold-plating the network and produces reasonable results.

The third adjustment made by Mr. Tucek is suspect. By removing all loops carried by DLC's in the model, Mr. Tucek removes a significant portion of the highest-cost loops. The resulting product only yields the rate of the least-cost loops in Verizon's network. As a consequence of this, Mr. Tucek's true up is meaningless -- it compares only Verizon's lowest-cost loops to retail rates. These will of course compare favorably

to retail rates. However, this is because a great many high-cost loops have been assumed away. Consequently, any comparison with the existing network rates is meaningless.

2. Use Of Existing Interstate Access Rates To Determine Verizon's Switched Access Costs Is Improper

Verizon argues that the Commission should not consider how its switched access cost estimates compare with either its current intrastate-switched access rates or its current interstate-switched access rates. Verizon IB at 25-27. Verizon makes this argument despite its own use of such comparisons. See Verizon Ex. 5.0 at 5; Verizon Ex. 2.0 at 5. In fact, at one point, Verizon goes so far as to imply that its retail local service rates should be used to assess its cost estimates. Verizon asserts that "[t]he suggestion that a CLEC should be charged on a per-line basis for a port and all of the associated usage is based on reasoning that is fundamentally flawed. If switching costs were not indeed usage-sensitive, then local service should be charged on a flat-rate basis instead of on a measured basis." Verizon IB at 58. Clearly, Staff's comparisons, which are considerably more appropriate and justified than this comparison by Verizon, constitute a useful comparison.

With respect to comparisons between ICM estimates and existing interstate-switched access rates, Verizon argues "…comparison of ICM with earlier cost studies disregards differences in the underlying assumptions and cost methodologies." Verizon IB at 25. Then, in complete contradiction to this assertion, Verizon notes that with the exception of shared and common costs that there are no major changes between the ICM and the methodology used to generate the existing Verizon switched access rates. *See* Verizon IB at 25-26 ("The major difference between the ICM and the methodology

underlying the earlier study is that the earlier study did not include the costs that ICM identifies as 'shared' costs.")

Notably, Verizon later identifies two other factors, presumably not major factors, that increase ICM cost estimates relative to existing cost estimates: "differences in the composition of the network due to the sale of wire centers to Citizens" and "exclusion of circuit equipment from the loop costs underlying the existing rates." Verizon IB at 26. In the absence of any other major differences between ICM methodology and existing methodology, it is unclear why Verizon has proposed an entirely new cost methodology rather than submitting its existing cost studies with revised shared and common factors and allocations.

To the extent one focuses, as Verizon suggests, on the ICM methodology, one readily identifies a number of deficiencies in Verizon's cost modeling methodology. In some circumstances, the quantitative effect of these deficiencies is unclear or indeterminate. *See, e.g.*, Staff IB at 33. As Dr. Zolnierek notes, "[i]n my opinion, Verizon's schizophrenic approach to modeling is outcome-driven." Staff Ex. 2.1 at 11. Taking all of these factors into consideration, it is certainly appropriate to examine all available evidence to determine, to the extent possible, whether the outcome of Verizon's model methodology is reasonable.

Granted, the Commission should not give excessive weight to the importance of inter-rate comparisons in making its decision. For example, Staff has made it clear that the interstate-switched access figures it uses in its comparisons are imperfect substitutes for interstate-switched access rates. *See* Staff Ex. 2.0 at 10-11. If Verizon is able to correct the deficiencies in its cost model methodology, and can demonstrate

how its current methodology improves the accuracy of its cost estimates (or, at the very least, submits evidence that enables the Commission to reasonably make such a determination on its own) then inter-rate differences may be of little consequence. However, Verizon has neither corrected the deficiencies in its model, nor demonstrated that its current methodology improves upon that used to develop its existing intrastate switched access rates. Therefore, the Commission should not, as Verizon requests, ignore evidence at its disposal when evaluating the reasonableness of Verizon's switched cost estimation methodology.

D. ICM Models A Disproportionate Network

1. The Number Of DLCs Modeled By The Network Is Excessive

Verizon witness Tucek concedes that there are more DLCs modeled in the ICM network than exist in Verizon's actual network in Illinois. Mr. Tucek argues that there is no way for the ICM to model fewer DLCs, even under the 18kft loop-length restriction option. Verizon Ex. 2.0 at 14, 15. Staff agrees with Mr. Tucek concerning this matter, but do not see how this supports Verizon's claim that ICM does not model too many DLCs. In fact, this statement only supports Staff 's position that ICM is inadequate because it cannot be adjusted to reflect a more reasonable network.

Verizon also argues that the difference between the dollar amounts of circuit equipment investment modeled by ICM is actually lower than the reproduction cost of the existing network. Verizon Ex. 2.0 at 15. Staff is not persuaded by this argument. First, the reproduction cost calculations provided by Mr. Tucek are speculative in nature. A disclaimer that it relies on broad assumptions and is not based on an actual accounting of current investment costs must accompany any use of this data. Second, even if circuit equipment prices of the ICM modeled network were found to be lower

than the actual reproduction costs of the existing network, this argument is a red herring. If the ICM placement of DLCs is inefficient, it does not matter what its cost is in comparison to the existing network. An inefficient network is not LRSIC or TELRIC based, and as such cannot be used as a basis for developing UNE rates in Illinois. Further, the investment in DLCs does not exist in a vacuum. The impact of placing DLCs inefficiently extends also impacts the efficient copper-fiber mix in the network. With too many DLCs, regardless of the investment, there will be too much fiber, which also drives up the cost of the network.

Mr. Tucek also uses the FCC Advanced Services Order (CC Docket No. 98-147), dated March 31, 1999, as a basis of support for Verizon's choice of network modeling. Mr. Tucek cites from the Advanced Services Order that ADSL as the most commonly deployed of these technologies. Using this fact, Mr. Tucek reasons that the ICM must model a network capable of ADSL speeds throughout its Illinois network. Although Staff would support a decision by Verizon to upgrade its telephone network to provide state of the art broadband technology to its customers, such support would have to be tempered with the efficiency losses that such an upgrade may yield. It is inherently inefficient to model a network that ubiquitous deploys ADSL technology.

As Staff witness Robert Koch argued in direct testimony, advanced services are defined at a much lower capability level in Illinois. Staff Ex. 1.0 at 12 *et seq.* Further, the Illinois Legislature has set the penetration benchmark for advanced service availability at 80% of the customer base. 220 ILCS 5/13-517(a). As the ability to provide high bandwidth services increase in the network, so does the cost. Staff Ex. 1.0 at 12 *et seq.* The network design in ICM maximizes broadband capability rather than maximizing

efficiency. The result is a network that is not consistent with current public policy in the State. Further, Mr. Tucek's position completely ignores the fact that the ICM modeled network is not forward-looking. Nowhere is Verizon's direct of rebuttal testimony to this case is it stated that ICM models a network that exists today in Illinois or is even on the planning horizon. Indeed, as the Staff noted in its Initial Brief, Verizon has indicated that it has no intention of building such a network. *See* Staff IB at 13 (noting that Verizon seeks a waiver of the Section 13-517 requirement that ILECs make high speed data service available to 80% of customers by 2005).

2. Improper Choice of DLC Equipment

In Staff's opinion, the model should utilize, to the extent necessary, traditional loop carriers as opposed to next generation DLCs ("NGDLCs") currently utilized by the model. Staff's argument is based on efficiency concerns and the appropriate design of a forward-looking network. Although Mr. Tucek takes exception to Staff's position, he fails to provide support for his opposition. Verizon Ex. 2.0 at 16, 17. For example, instead of providing rationale for Verizon's position that NGDLCs are suitable to utilize throughout the network, Mr. Tucek only discusses his disagreement with Staff witness Koch's definition of NGDLCs. This disagreement concerning Staff's definition of NGDLC does not support his position.

Indeed, NGDLCs are necessary to employ forward-looking networks. Staff does not dispute this fact. However, Staff is concerned with the company's placement of these devices, specifically, whether the NGDLCs are placed efficiently. As noted throughout this proceeding, ICM requires NGDLC placement throughout Verizon's entire network. Verizon assumes -- questionably, at best -- that forward-looking networks must contain the most advanced capabilities possible throughout the network.

In support of this position, Verizon asserts that the FCC requires the design of a TELRIC network to not impede advanced services deployment and that engineering guidelines prohibit copper loop lengths greater than 18kft. (CITE) Verizon has misinterpreted the FCC decision as requiring that ADSL capability for all customers, no matter how costly, in the design of the network. This interpretation is illogical when put into practice. Staff believes that such an interpretation passes typical DSL speeds and models an extremely advanced network. Further, Verizon implies that it is bound to engineering guidelines that prohibit copper loops in excess of 18kft. If this were a guideline that Verizon follows, then there should be evidence of this pattern within in the company's existing network. To show the Commission that the company provides NGDLC equipment to all loops in excess of 18kft would be much less complicated. However, no such information has been provided to Staff.

Moreover, Staff correctly maintains that the placement of NGDLCs throughout Verizon's modeled network allows the company the capability of providing advanced services throughout the network. Choosing to use traditional DLCs in certain areas of the network may have consequences that may essentially prevent some customers from being able to receive advanced services. Staff's methodology is consistent with the current network deployed by Verizon, and also with Verizon's actual plans regarding the future configuration of its network. *See* Staff IB at 13 (noting that Verizon seeks a waiver of the Section 13-517 requirement that ILECs make high speed data service available to 80% of customers by 2005). Further, Staff's methodology remains consistent with any potential planned network changes.

Lastly, Staff's recommended use of a more prudent design does not impede Advanced Services. Granted, some customers would not be able to receive advanced services under Staff's methodology. Rather, Staff's design more reasonably restricts the placement of more costly NGDLCs to those areas in which it would be practical to provide such services. As such, the SLC-96 that Staff offered as an example in response to data request VZ-Staff 1.04 can be said to be forward-looking as long as it is the most efficient means of providing telephone service to some customers in the network. Verizon addresses concerns presented by IRCA witness Jason Hendricks regarding DLCs that serve customers at well under capacity. Staff finds Mr. Hendricks' arguments in support of this issue persuasive. In response to this, Verizon concedes that 4.7% of DLCs in the modeled network serve five or fewer customers. This is a very uneconomic result for the model, rather than proof that the problem is insignificant.

Similarly, with respect to Verizon's analysis for positioning both, it's DLC material and its placement investment at zero is untenable. Contrary to Verizon's contention, Staff believes that a $1.23 impact on loop costs is a significant concern. Moreover, setting DLC investment at zero does not negate the impact the DLC has on fiber-copper placement. As a general matter, notwithstanding a zero investment for the DLC, the DLC still exists in the modeled network and may lead to an inefficient placement of fiber, driving up costs as a result. Therefore, the impact of this issue exceeds the $1.23 stated by Mr. Tucek.

3. ICM Improperly Models Two Local Loop Networks

Verizon claims that the benefits of utilizing a separate network approach outweigh Dr. Zolnierek's criticisms of ICM that modeling two networks ignores the benefits and reasons for Verizon adopting this approach. Verizon IB at 31 *et seq*.

Verizon contends further that Dr. Zolnierek's testimony does not address the purported fact that Verizon's separate network approach results in lower costs, nor does it offer an alternative methodology for estimating the TELRIC of an unbundled loop. Id. Although, in Verizon's estimation, Dr. Zolnierek is correct that the wholesale-modeled investment is greater than that of the retail configuration, Verizon asserts that he ignores the record evidence that demonstrates the increase is not significant. Id. Verizon notes that for the two affected accounts (Digital Electronic Switching and Circuit Equipment), the increase in the modeled investment is less than 2.3% and 1.9% for the 12kf and 18kf runs, respectively. For both runs, the increase in *total* modeled investment is less than 0.5%. Id.

In this proceeding, Dr. Zolnierek identified Verizon's approach of building one type of network when estimating switched access investment costs and another type of network when estimating UNE investment cost as a significant problem; in particular Dr. Zolnierek noted, "…aggregate wholesale switch investment in the model exceeds aggregate retail investment." Staff Ex. 2.0 at 26. In his rebuttal testimony, Mr. Tucek acknowledged that switch investment in the wholesale model run exceeds switch investment in the retail model run, noting, however, that the difference was "not significant." Verizon Ex. 2.0 at 21. Thus, to be clear, Verizon is estimating that its switching investment is higher when it provides UNE switching to CLECs than it is when it provides either switching as part of switched access to long distance carriers or when it provides switching to itself to serve its own customers.

Verizon argues that its estimation approach and estimates are appropriate for three reasons. First, Verizon argues that in practice it may provision UNE loops in a

different manner than what is modeled (i.e., transferring the loops to copper feeder facilities and terminating them on a D4 channel bank rather than using a UDLC configuration) and that the modeled approach is the lower cost alternative. Verizon IB at 32. Second, Verizon argues that its approach of assuming an all wholesale network when estimating UNE switching investment and an all retail network when estimating switched access or retail switching investment will yield higher fill rates than assuming a network that is configured partly to serve UNE customers and partly to serve retail and switched access customers. Id. Finally, Verizon argues that over time the mix of customers served by Verizon and by CLECs using Verizon's UNEs will fluctuate. Id.

These arguments are deficient in two respects. First, Verizon's argument that its actual practice does not match the forward-looking practices it models provides yet another example of the confusion in Verizon's approach to TELRIC modeling. As noted by Dr. Zolnierek, Verizon's arguments above simply assert that the Commission should accept this methodology because it produces a lower cost—not because it is correct and TELRIC-compliant. Staff Ex. 2.1 at 11.

Second, the notion that Verizon might have to switch lines from retail configurations to wholesale configurations, and back is ill conceived. Verizon has proposed numerous non-recurring costs for carriers that request UNEs. Any justifiable costs associated with converting lines from retail type configurations to wholesale type configurations are properly included in such non-recurring costs. Thus, Verizon's reference to these costs when examining recurring cost investment figures is misplaced.

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Staff agrees, however, that Verizon's approach will, in theory, produce higher fill factors than an approach which models a single dual-purpose network with the respective wholesale and retail type configurations used by Verizon. Further, Staff believes there is some merit in the position that a cumulative difference of 0.5% (in total modeled investment) may be insufficient to justify the additional correction, particularly as further complexity may create additional problems. In sum, despite the shortcomings in Verizon's position, Staff accepts Verizon's approach to generate switch investment. With respect to accuracy, however, Staff notes that such an approach may influence the allocation of shared and common costs between wholesale and retail products and services.

F. ICM's Expense Inputs Common Cost Study

With respect to Verizon's common cost study, Staff, in general, finds that the expense inputs do not accurately support the model's allocation of shared and common costs. Verizon did not make its *prima facie* case in support of its submitted shared and common cost study; specifically, the company did not provide sufficient factual or legal bases upon which Staff could make a recommendation in support of the study. Staff's belief is supported, in part, by ICM's failure to produce forward-looking costs from methodology that is both reasonable and sound. That said, Staff would not address the merits of specific positions raised by Verizon with respect to this issue.

Staff's silence on a specific argument regarding Verizon's common cost study, however, does not indicate its agreement or disagreement with a particular position.

From the outset, it is important to note that the disagreement between Verizon and Staff does not lie with the weighting factors used to distinguish between modeling issues and ICM input issues. Rather it lies with the accurate amount of evidentiary

weight to be given to ICM's expense inputs to properly evaluate the model consistent with the goals of this phase of the docket. Therefore, as "the principal goal of the hearing process is to assemble a factual record to serve as a basis for a correct and legally sustainable decision,]" 83 Ill. Admin. Code 200.25, Staff considers it essential to reiterate its position.

The expense inputs provided by Verizon and the corresponding results displayed by ICM do not provide evidence adequate for Staff to support, or the Commission to adopt, the submitted common cost study. In its Initial Brief, Staff argued that Verizon had not provided the Commission with adequate support for ICM's allocation of shared and common costs. Staff IB at 41. Similarly, Verizon articulated its understanding of the relevant issues regarding its expense inputs and the corresponding phase. It stated,

> In deciding Phase I issues, the Commission must distinguish between modeling issues and ICM input issues. Modeling issues relate to the propriety of ICM itself—a Phase I issue. In producing costs, ICM incorporates numerous expense inputs. The propriety of ICM's expense inputs as they relate to UNEs is Phase II issues. Although parties inevitably discussed ICM's expense inputs in Phase I in order to properly evaluate the model, the rejection of a particular input does not warrant a Commission rejection of ICM as a whole.
>
> Verizon IB at 36.

To the extent that Staff discussed ICM expense inputs for evaluation purposes, Staff clarifies that a rejection of a particular input should not be construed as a *per se* rejection of the entire model. Rather, the Commission should consider Staff's concerns with respect to ICM's expense inputs, taken together, when determining the reasonableness of ICM's common cost study.

Staff further notes, with respect to the allocation of the company's shared and common costs, Staff asks the Commission to reject ICM's **calculations**, not the entire model. Staff specifically articulates, " ... until Verizon provides more support for certain calculations and verifies how certain items of shared and common costs are related to the service to which it is assigned, these **calculations** should be rejected." Staff IB at 41-42. (Emphasis added).

This information is produced only to demonstrate the deficiencies of the common cost study, the existence of which is relevant to the approval of the model. In Staff's opinion, it is difficult to conclude that ICM accurately measures the company's shared and common costs. This factor is one factor among many others considered by Staff in preparing its recommendation for this phase of the proceeding.

This opinion is not offered as a *per se* rejection of the whole model. Accordingly, before the Commission makes its independent assessment of ICM and before the Commission determines whether to accept or reject the model, Staff urges the Commission to take note of an important clarification as expressed below.

Certainly, Verizon may have raised fair questions about the proper focus of Staff's analysis of ICM. However, at this juncture, whether Verizon can show its expense inputs produce reasonable results is at most premature. In fact, in ICC Docket No. 00-0511/00-0512 (consol.), the Commission identified the scope of this docket so as to address the pricing of Verizon's UNEs in three phases. The Commission concluded:

> Phase I will review a cost model submitted by Verizon, and evaluate and establish access charges. **Phase II will evaluate the "UNE cost information", and will commence after Phase I is concluded.** Phase III will review and decide Verizon's avoidable costs, and will set wholesale rates. **The UNE cost**

> **information will address shared and common costs**, therefore, the shared and common cost allocator for collocation will not be completely out of place. Furthermore, this will allow the Commission to approve a shared and common costs methodology that is consistent for UNEs and collocation, which is consistent with the Commission's finding in Docket 96-0486--that "the methodology used for allocating shared and common costs should be consistent for all network elements.
>
> ICC Docket No. 00-0511/00-0512 (consol.) at 4, citing *Order,* Docket No. 96-0486 at 54 (emphasis added).

Clearly, the merits of ICM's expense results as they relate to the reasonableness of the company's shared and common cost study are issues to consider in Phase II. A cursory review of Verizon's offerings to support ICM's expense inputs reveals that it falls short of complying with state law and Commission Orders. In short, Verizon has failed to establish a valid theoretical foundation to support its common cost study and it also has failed to address Staff's request for evidence to support its position.

As Staff recommends in its Initial Brief, the Commission should, therefore, order adjustments to the model that incorporate the various Commission and FCC Orders and rules that have been identified in the parties' Initial Briefs. As a threshold matter, however, it is difficult to determine precisely how Verizon reached its conclusion that its shared and common estimates are reasonable. Nonetheless, Staff believes that the substance of these results is argument for Phase II. Accordingly, to the extent this record contains opinion evidence pertaining to the propriety of the model's expense inputs as they relate to UNEs, such arguments are at best premature and should be deferred and shortly revisited in Phase II.

G. ICM Improperly Models Switching Costs

The ICM model does not, as Verizon states "…have decision-making capability with respect to switch type placement." Verizon IB at 55. Verizon attempts to cast this as an input issue and not a modeling (i.e. ICM) issue. Tr. at 39. Verizon, however, is incorrect. Verizon's failure to incorporate decision-making capability into its estimation methodology is decidedly a "model" and not an input problem for several reasons.

First, as explained above, by basing its cost estimates on embedded technology choices—choices inconsistent with current prices—Verizon necessarily inflates cost estimates. Second, as Verizon notes the purpose of the ICM is to calculate TELRIC and TSLRIC based cost estimates. Verizon IB at 4. When describing how ICM calculates TELRICs of individual UNEs and TELRICs of retail services, Verizon states "ICM does this by designing the network all at once, using currently available, forward-looking technology and the prices for labor, material and equipment that Verizon is actually able to obtain." Verizon IB at 4. However, the ICM does not design the entire network. It does not design the switching network, it merely, as Verizon concedes, incorporates Verizon's embedded switching architecture. Thus, ICM fails to do what Verizon claims it does, design a forward-looking network.

One could create a model independent from the ICM that contains decision-making capability and generate switching cost inputs that are forward looking. There are, however, two problems with this approach. First, the fact that such action is required at all simply confirms the fact that ICM is not serving the purpose for which Verizon states it was created, to design a forward looking network. Second, as a pragmatic matter, Verizon's model does not readily accept any switching inputs that do not match its embedded switching architecture.

For example, the ICM has been designed to accept over 18,000 switch investment records from SCIS and CostMod. "CostMod allows the user to generate a file that is in the format used by ICM. SCIS-IN (the SCIS module used to develop features and usage costs) allows the user to create a comma-separated file containing the required values that is readily accepted by ICM." Tucker Rebuttal at page 65. As noted by Mr. Tucek, these models are each based on Verizon's embedded architecture. *See* Tr. at 63 ("The traffic characteristics, host remote relationships that exist in Illinois' network are accounted for by SCIS and COSTMOD. You don't need to do that to calculate the discounts.") Thus, absent significant and fundamental revision of the ICM, the user cannot merely substitute different switch cost inputs. As a practical matter users must use SCIS and CostMod, which are models based on Verizon's embedded network.

It is clear that Verizon fails to adhere to both Commission and FCC cost rules by failing to adopt either "the least cost technology that is currently available whose cost can be reasonably estimated based on available data" or "the most efficient currently available and the lowest cost network configuration" as required by the Commission and FCC, respectively. *See* 83 Ill. Admin. Code 791.20(c); *see also* 47 CFR § 51.505(b)(1). This problem is not simply an input problem. As explained above, it is a result of the design of the ICM model.

The demand data used by ICM to model the network is inadequate. Staff Ex. 1.0 at 16 *et seq*. Since demand used in ICM is not forward-looking, the network produced by ICM is also not forward-looking. Id. Verizon has not rectified this problem; and consequently Staff believes the matter must be addressed.

Verizon does not advance a colorable rationale to support ICM's 6 mbps transmission speed option. The only argument that Verizon makes along these lines is that Verizon chose to model their network with the capability of providing the most common form of advanced services, ADSL. Verizon IB at 21; Verizon Ex. 2.0 at 34. The goal in this proceeding, however, is to develop costs for loops that will be used primarily for voice communications. Verizon does not attempt to argue why the network developed by ICM is the most appropriate means for determining TELRIC costs. Staff and Interveners have gone to great length showing the inefficiencies of the modeled network.

Staff agrees completely with Verizon that ICM should not be rejected because it proposes to use the 6 Mbps option for the development of costs; rather, it recommends the rejection of ICM on numerous other grounds. None of the three network options in ICM are TELRIC or LRSIC compliant, nor does it appear that there is a way in which the model can produce TELRIC or LRSIC compliant costs. *See* Staff Ex. 1.1. Accordingly, unless the company can rationalize and provide further support for purposes of Staff's concerns, Staff has difficulty advocating in support of the model.

G. Census Data

Verizon has provided sufficient evidence that demonstrates that 2000 Census data cannot be employed for this proceeding. However, this evidence demonstrates a shortcoming of the model- that it is not adaptable to demand changes over time. This is particularly troublesome, as it implies that new, updated data cannot be integrated into the model. Therefore, the Commission is stuck with old data from the time of the first use of the model.

The problems with updating this data show a significant weakness of ICM. The model depends on demand data to produce reasonable estimates of network costs. When this data becomes outdated (which it arguably already is), so does the model. Even if ICM produced a perfect, efficient model based on the demand data, if the data itself is incorrect then the product of the model is going to be incorrect. In the computer programming industry, this is referred to as "garbage-in, garbage-out" dilemma. As such, the useful life of ICM does not appear to be long.

Staff does not know what a sufficient remedy to this problem could be, other than to use demand sampling to estimate costs, rather than to rely on an outdated data set to model the entire network. At least with sampling and statistical methods, there is a known degree of confidence that can be controlled.

H. Verizon purchases switches on a per-line basis

Verizon contends that Staff misunderstands the fundamental nature of switching *See, generally*, Verizon IB at 57 *et seq*. Since switching costs constitute a significant portion of costs associated with provision of telecommunications service, a full understanding of Verizon's contentions regarding the Staff's position is necessary. Accordingly, Staff will recapitulate Verizon's argument at some length.

Verizon argues in its RB, in support of the proposition that Verizon switches should not be offered on a per-line basis, as follows:

> The procedure for the model office configurations covered by the Nortel contract are based on fixed number of trunks per line consistent with a specified CCS per line and also allow for the specification of non-SRII trunks, equipment and software. Except for the line modules, all of these components are sized based

on the number of required trunks and on the offered load.[1] SCIS was subjected to an independent audit conducted by Arthur Andersen[2].

In support of this contention, Verizon argues that it does not purchase switches on a per-line basis because the company incurs switching costs on a usage sensitive basis. Verizon IB at 59-60. Verizon maintains that previous Commission decisions do not support the proposition that switching costs are incurred on a flat rate basis. Verizon IB at 59. Verizon acknowledges ICC Docket No 00-0700, which states, "the Commission found that Ameritech's switching costs were not incurred on a per-line basis." Verizon IB at 58, n. 18. Because this argument contradicts rather than supports Verizon's position, Verizon asserts that the reasoning in the order does not apply to Verizon. Id. Thus, the one order cited by Verizon, even under the interpretation most favorable to Verizon, simply does apply to Verizon or support Verizon's position that flat rated switching costs are "in direct opposition to earlier findings of the Commission." Verizon IB at 59.

In fact, the Commission also found that switch costs were incurred per line, with a small amount of usage costs each time the switch is activated, in other proceedings. In its *Second Interim Order* in Docket No. 96-0486, the Commission found that:

> Based on a review of Ameritech's switching contracts**, it is clear that the primary basis used by switch vendors to charge Ameritech for its switches is a price per line.** Because Ameritech incurs switching costs on a **predominantly per-line basis**, we find it consistent with the fundamental principles of cost causation that the ULS subscriber should also pay the ULS element primarily on a per line basis, without a usage charge.

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[1] See Tucek Sur., Verizon Ex. 3.0, pp. 219 and 222-229 IN THE PDF.

[2] The Staff has no doubt that an audit by Arthur Anderson found the costing principles underlying SCIS to be appropriate, and failed to reveal any discrepancies in them. Whether such an audit can, in light of intervening developments, be viewed as particularly authoritative is, perhaps, another question entirely.

Second Interim Order at 151, Investigation into forward looking cost studies and rates of Ameritech Illinois for interconnection, network elements, transport and termination of traffic, ICC Docket Nos. 96-0486 / 96-0569 (consol.) (February 17, 1998) (hereafter "TELRIC Order") (emphasis added)

The Commission reiterated this finding in its Order in Docket No. 98-0396, when it found that: "Our extensive investigation of Ameritech's ULS cost structure conclusively demonstrated that Ameritech's switch costs are **not usage sensitive**…[.]" Order at 65-66, Illinois Commerce Commission On Its Own Motion: Investigation into the compliance of Illinois Bell Telephone Company with the order in Docket 96-0486/0569 Consolidated regarding the filing of tariffs and the accompanying cost studies for interconnection, unbundled network elements and local transport and termination and regarding end to end bundling issues, ICC Docket No. 98-0396 (October 16, 2001) (hereafter "TELRIC II Order") (emphasis added). Indeed, Verizon points to no Commission finding – and the Staff is aware of no finding – that switch costs are incurred on a usage-sensitive basis. It is, moreover clear that the Commission has conducted an "extensive investigation" of Ameritech's switching contracts, in no fewer than three proceedings, and has found that, based upon those contracts, switching costs are incurred on a flat-rate, rather that usage-sensitive, basis.

Verizon will perhaps argue – with, at least facially, some justification – that Ameritech's switching contracts and Verizon's may be markedly dissimilar. However, in a forward-looking cost environment, such an assertion proves, upon scrutiny, chimerical. Verizon and Ameritech are local exchange carrier affiliates of the two largest national ILECs. Both were acquired in mergers, which were purportedly justified in part by economies of scope and scale that would accrue to the merged companies. It is

impossible to conclude that one such economy of scope and scale is not the procurement of switches and associated technology. In fact, it would be very surprising indeed if Verizon and Ameritech/SBC – two of the largest and most sophisticated purchasers of such technology in the world – entered into switching contracts on materially different terms and conditions from one another. Accordingly, Verizon cannot colorable argue that the Commission's findings regarding Ameritech's switching contracts cannot provide guidance regarding the manner in which switch costs are incurred industry-wide.

Apart from the reference to the Commission decision in Docket No. 00-0700 Verizon argues, "[i]f switching costs were not indeed usage-sensitive, then local service should be charged on a flat-rated basis instead of on a measured basis." Verizon IB at 58. Earlier in its brief Verizon states:

> …Staff and IRCA comparisons to retail monthly access charges are simply outrageous and indicative of their misunderstanding of the ratemaking process. It is anything but 'a simple logical conclusion' that the retail monthly access rate should bear any similarity to the UNE loop cost. The retail monthly access rate is a product of the retail rate design.
>
> Verizon IB at 24

Apparently Verizon does not find UNE to retail rate comparison "simply outrageous" when such comparisons work in Verizon's favor. Verizon is estimating its costs in this proceeding. These costs will be used to determine its UNE rates. Retail rates do not and cannot determine the forward-looking cost of providing service. Verizon's attempt to justify usage sensitive rates based on its retail cost structure should be rejected.

The second argument Verizon makes to support its argument that it incurs switching costs on a usage sensitive basis is that switching capacity is constrained by

three factors "the number of lines and trunk terminations, the amount of traffic offered by the terminations; and the call processor rate." Verizon IB at 58. Verizon then explains why, in its view, this is so. Verizon IB at 58-59. However, if these are indeed the three factors that determine Verizon's switching costs, Verizon should have obtained switch cost estimates from its vendors based on these factors. Verizon states that "[o]ther than his assertion that 'a substantial portion of the price Verizon pays Nortel for switches is determined by line counts and is not usage sensitive,' Mr. [sic] Zolnierek has produced nothing." Verizon IB at 62.

By so asserting, Verizon is in essence arguing that Staff cannot rely on the vendor bids that Verizon submitted, but must make some type of showing that the vendors actually price according to the bids they submitted. In contrast, Verizon has gone to great length to show why the bids that it submitted as evidence do not reflect the manner in which vendors set prices. This seems, at best, counterintuitive; if vendor bids have no relationship with prices, the solicitation of bids appears to be a useless act. Since, however, Verizon took the trouble to solicit bids, it presumably thought that switch vendors' bids had some relation to price. Not only does Verizon alter the cost structure inherent in its vendor bids, but it does so by using SCIS and COSTMOD, models which Verizon has not shown are related in any way to the cost structure Verizon asserts the vendors actually use.

Verizon's arguments for using these models to alter its vendor supplied bid prices is that other state Commission have accepted these models and that Arthur Andersen audited some version of the models 10 years ago. The evidence does not, as Verizon asserts, "… demonstrate that the unit costs produced by SCIS and CostMod are the

best available estimates of Verizon's forward-looking switching costs …[.]" Verizon IB at 64. The fact is that Verizon's ICM model is, in its current form, unable to process the cost estimates Verizon has obtained directly from vendors and thus the unit costs produced by SCIS and CostMod are the only estimates that work with the ICM.

IV. THE COMMISSION SHOULD EXAMINE VERIZON'S NON-RECURRING COSTS AND LOADED LABOR RATES IN PHASE II OF THIS PROCEEDING

An examination of Verizon's Non-Recurring Costs ("NRC's") associated with the provisioning of UNE's to CLECs is not appropriate for Phase I of this proceeding. The scope of addressing NRC's is limited to the issue of the unbundled network cost information that has been provided by Verizon for purposes of this Commission investigation. Indeed, ALJ Woods has indicated this assertion on the record when he established the three phases of this proceeding. ALJ Woods stated:

> Judge Woods**:**
> The record would also reflect the fact that we had distributed a suggested schedule that calls for the docket to be separated, essentially, into three phases. **Phase 1** will review a cost model submitted by Verizon in conjunction with its original filing and the application of that cost model to access charges. **Phase 2** will review the **unbundled network element cost information** provided by Verizon. My understanding is also at that time it will be argued—the parties will be arguing the necessity of tariffing those unbundled network element costs, and in the event that tariffs are not necessary the costs will, nonetheless, be established and imported for use into Verizon's interconnection agreements. **The final phase** will review and decide Verizon's avoidable costs, and will then set22 wholesale rates.
> I have a schedule proposed by Staff. The parties have reviewed that schedule and have accepted it."
> Tr. at 5-6 (Emphasis Added)

As further support, ICC Docket No 00-0511/00-0512 (consol.) articulated the phases set out in the instant docket. In doing so, the Commission made a note of the following:

> "**Docket No. 00-0812** addresses the pricing of Verizon's UNEs ("Unbundled Network Elements") in three phases. Phase I will review a cost model submitted by Verizon, and evaluate and establish access charges. **Phase II will evaluate the "UNE cost information"**, and will commence after Phase I is concluded. Phase III will review and decide Verizon's avoidable costs, and will set wholesale rates."
> ICC Docket No 00-0511/00-0512 (consol.) at 12. (Emphasis added)

As the record indicates and supported in 00-0511/00-0512 (consol.), Phase II is the proper proceeding for such costs to be addressed.

Verizon maintains that while phase I of this proceeding is limited to the application of ICM to switched access, the NRC study complements ICM and together these studies provide an accurate and reasonable estimation of Verizon's forward looking costs associated with the provision of access services. Verizon IB at 75.

Verizon, however, asserts the following with respect to the classification of costs in its proposed NRCs:

> "Verizon's NRC Access Cost Study classifies two types of costs associated with the processing of wholesale service orders. First are the costs that Verizon incurs when a CLEC places an order for an access service or an activity. Second are the costs associated with the provisioning and installation of the order or activity (*e.g.*, technician costs)."
> Verizon IB at 76.

As Verizon indicates above, its NRCs are within the wholesale service arena. Id. It is notable that Verizon refers to a CLEC rather than an IXC in the language cited above. CLECs use unbundled network elements in order to provision their services, IXCs use switched access services. Although there may be many common activities associated with placing an order for either a CLEC or an IXC, determining the NRC for provisioning of unbundled network elements reserved for Phase 2 of this proceeding. In Staff's opinion, the ICM model does not develop Verizon's NRCs. ICM is the cost

model referred to by Judge Woods in establishing the phases for this proceeding. Therefore, since ICM does not develop NRCs for unbundled network elements, they are not within the scope of this phase.

With respect to the company's loaded labor rates (LLRs), currently, Staff has not offered a recommendation to the Commission regarding Verizon's LLRs. Since the three phases have been established in this docket, Staff has intended to offer an opinion regarding Verizon's LLRs in Phase II of this docket. Consequently, any arguments on behalf of Staff regarding LLRs should not be deemed as an analysis, opinion, and/or recommendation on this issue. That said, at this juncture, the arguments put forth by Verizon in its Initial Brief, Verizon IB at 78-84, pertaining to Staff's analysis of the company's LLRs, will not be refuted by Staff.

To incorporate LLR analyses within UNE investigations is not a foreign procedural concept to this Commission. The Commission's Initial Order in ICC Docket No. 00-0511/0512 determined that "Verizon has incorrectly included in its labor rates, costs that are shared, common or should be included in another labor rate." Initial Order at 17. Likewise, the Commission's goal on rehearing, *inter alia*, was to determine whether Verizon is permitted to recover the costs the Commission denied in the Initial Order. ICC Docket No. 00-0511/0512. In rendering a decision, the Commission suggested that **Phase II** of the instant proceeding would be the most reasonable to address the inaccurate inclusions to Verizon's LLR since parties will evaluate Verizon's "UNE cost information" in that phase. The Commission stated the following:

> "The UNE cost information will address shared and common costs, therefore, the shared and common cost allocator for collocation will not be completely out of place. Furthermore, this will allow the Commission to approve a shared and common costs methodology that is consistent for UNEs and collocation, which is

> consistent with the Commission's finding in Docket 96-0486--that "the methodology used for allocating shared and common costs should be consistent for all network elements." Order, Docket No. 96-0486 at 54."

Consistent with the above Commission Order, Staff intends to put forth its analysis and tender its recommendation regarding LLRs at the time Staff presents its evaluation of the company's UNE cost information, namely Phase II. However, as stated in Staff Ex. 3.1, Staff does not object to any of the evidence presented in this Phase of the proceeding being used in Phase 2 on issues concerning LLR. Staff does agree with the position of IRCA that to the extent, any of the components in LLR are supporting costs in any development of switched access rates; they should be removed pending final determination of the issue in Phase 2 of this proceeding.

Moreover, Staff agrees with ATT that Staff's position with respect to switched access NRCs be adopted. This method is consistent with Staff's position on recurring switched rates. Verizon has not proposed changing its present non-recurring charges for switched access rates even though they filed cost studies purporting to show that the costs for those services substantially exceed the rates. Staff believes that those studies are flawed. However, Staff does not believe there is much to be gained by making any determination on the merits of a cost study if the results of that study are not used to support cost based rates.

In this proceeding, Verizon was to submit forward-looking switched access cost studies and rates based upon those studies so that the Commission could establish rates based upon forward-looking costs. Verizon did not undertake that activity with respect to non-recurring charges associated with switched access services. Rather, it filed a cost study laden with non-forward looking elements and apparently had so little

faith in it they did not even propose to establish rates based upon that study. Staff believes the adjustments to present rates suggested by IRCA, is, itself, a reasonable solution to the problem, and should be adopted by the Commission.

V. STAFF'S RESPONSE TO IRCA'S ARGUMENTS

IRCA makes essentially the same arguments advanced by Staff with respect to ICM. Similarly, IRCA's arguments address the same general deficiencies identified by Staff with respect to the model's methodology, and accordingly Staff's arguments with respect to these issues are thoroughly addressed in its IB and will not be repeated here. However, IRCA has brought forth a new matter not raised by either Staff or AT&T that Staff believes is significant to comment. First, Staff disagrees with IRCA's proposal to incorporate FCC prices as an interim solution, as it is a Phase II issue. However, Staff notes that IRCA's proposal illustrates that there are alternatives available if the cost model cannot be salvaged.

Second, Staff cannot support permitting Verizon to apply proxy location development as an interim measure, as IRCA proposes. Moreover, IRCA asks that a new network configuration option be required in ICM that only restricts 80% of loop lengths to be less than 18kft. Staff disagrees. The company's forward-looking network should be designed in a manner consistent with Verizon's actual planned network design. Verizon has already indicated that it would be burdensome to build such a network and has sought a waiver of 13-517.

VI. CONCLUSION

The Staff does not recommend that the Commission authorize Verizon to develop its TELRIC costs using ICM, as the model is currently configured. As Staff has demonstrated, the model does not utilize forward-looking assumptions, models a gold-

plated network, and has other deficiencies that will result in inflated TELRIC costs and therefore excessive UNE rates.

Staff identified defects and proposed broad changes necessary to bring the model into compliance with TELRIC principles. For the most part, Verizon elected not to make these changes. To ensure implementation remains consistent with TELRIC principles, Staff recommends the Commission disapprove ICM until Verizon rectifies the identified shortcomings and provided opportunities for interested parties to re-evaluate its adjustments.

WHEREFORE, for all the reasons set forth herein, the Staff of the Illinois Commerce Commission respectfully requests that this Commission adopt its recommendations in this proceeding.

Respectfully submitted,

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